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FISCAL IMPACT STATEMENT

LS 7522 | **NOTE PREPARED:** Jan 19, 2011
BILL NUMBER: HB 1466 | **BILL AMENDED:**

SUBJECT: Economic Development and State Tax Matters.

FIRST AUTHOR: Rep. Reske | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: *Interim Study Committee on Economic Development*: The bill makes the Economic Development Study Committee a four year committee that expires December 31, 2014, with a membership including legislative and nonlegislative members. It requires the study committee to determine methods for eliminating or reducing the personal property tax statewide and the appropriateness of allowing local government the option of eliminating or abating personal property tax for new investment and economic development purposes.

IEDC Reports and Studies: The bill requires the Indiana Economic Development Corporation (IEDC) to collaborate with local economic development organizations and submit an annual report to the study committee regarding collaboration. It requires the IEDC to conduct a statewide study to determine specific economic sectors that should be emphasized by the state and by local economic development organizations within geographic regions in Indiana.

Entrepreneurship Education Programs: The bill requires the State Board of Education, the Commission for Higher Education, and the Department of Workforce Development to work together to develop entrepreneurship education programs for elementary and secondary education, higher education, and individuals in the work force.

Technology and Innovation Commercialization Programs: The bill requires higher education institutions to expand technology and innovation commercialization programs.

Capital Access Program: The bill makes the following changes regarding the Capital Access Program:
(A) Requires a loan applicant to form a volunteer peer review panel that is approved by the executive director

of a Certified Technology Park and the IEDC. It requires the panel to approve an applicant's business plan before a loan may be granted. It requires periodic peer review of the borrower's business operations and a certification by the panel that the business is or is not adhering to the business plan. It permits the IEDC to require full payment of a loan if a business is not adhering to the business plan.
(B) Requires loan recipients to participate in business and technical assistance programs a t a Certified Technology Park.
(C) Requires a lender to monitor a borrower's adherence to the business plan. It permits the lender to require full payment of a loan if a business is not adhering to the business plan. It permits the IEDC to terminate the lender from the program and withdraw IEDC's pledge for the loan if the lender fails to monitor the borrower.
(D) Requires the IEDC to adopt rules to implement these changes.

Corporate and Financial Institutions Tax Rate Reductions: The bill reduces the Corporate Adjusted Gross Income Tax rate and the Financial Institutions Tax rate from 8.5% to 5%.

Repatriated Foreign Corporate Dividend Deduction: The bill provides an income tax deduction for corporations that repatriate profits from controlled foreign corporations.

Exclusion of Interest on State and Local Bonds: The bill provides that the Adjusted Gross Income and Financial Institutions Taxes apply to interest on state and local bonds issued by a state other than Indiana or issued by a political subdivision of such a state.

Sunset of Tax Credits: The bill allows the Teacher Summer Employment Tax Credit to expire on January 1, 2012. It provides that an Enterprise Zone Loan Interest Credit may not be awarded for interest received on a qualified loan made after December 31, 2011. It allows the Neighborhood Assistance Credit to expire on January 1, 2012. It specifies that a Maternity Home Tax Credit may not be awarded for the providing, after December 31, 2011, of a temporary residence. The bill provides that an Enterprise Zone Investment Cost Tax Credit may not be awarded for a qualified investment made after December 31, 2011. It provides that a Community Revitalization Enhancement District Tax Credit may not be awarded for a qualified investment made after December 31, 2011. It provides that a tax credit may not be awarded for making available, after December 31, 2011, a health benefit plan. It also provides that a Small Employer Qualified Wellness Program Tax Credit may not be awarded for costs incurred after December 31, 2011.

Redevelopment Financing: The bill permits local governments to pledge revenue from the county adjusted gross income tax (CAGIT) and the county economic development income tax (CEDIT) for redevelopment financing.

Other: The bill also removes outdated individual income tax adjustments.

Effective Date: July 1, 2011; January 1, 2012.

Explanation of State Expenditures: *Interim Study Committee on Economic Development:* The bill establishes the Interim Study Committee on Economic Development for four years until the end of 2014. The Committee will consist of 17 members as follows: two Senators, two Representatives, the CEO of the Indiana Economic Development Corporation (IEDC) or the CEO's designee, four members appointed by the Governor, four members appointed by the President Pro Tempore of the Senate, and four members appointed by the Speaker of the House of Representatives. During the 2010 interim, the Legislative Council provided $16,000 budgets for interim study committees with 16 or more members, including for the Interim Study Committee on Economic Development which was structured the same as in this bill. The Committee held two meetings in Indianapolis, one meeting in Anderson, and one meeting in West Lafayette at a total cost of $6,355.

The Committee is to operate under the policies governing study committees adopted by the Legislative Council. The Committee must issue a final report before November 1st each year to the Legislative Council containing any findings and recommendations of the Committee.

This bill specifies that the Committee study the following topics during each interim:
(1) best practices in state and local economic development policies and activities;
(2) the use and effectiveness of tax credits and deductions;
(3) whether there are any specific sectors of the economy for which Indiana might have comparative advantages over other states;
(4) the extent to which Indiana's tax laws encourage business investment and any improvements that might be made to Indiana's tax laws;
(5) the extent to which Indiana's education systems support economic development;
(6) the benefits of existing CREDs and possible new CREDs as an economic development tool;
(7) methods for eliminating or reducing the personal property tax statewide and the appropriateness of allowing local government the option of eliminating or abating personal property tax for new investment and economic development purposes.
(8) any other issue assigned to the Committee by the Legislative Council or as directed by the Committee's Co-Chairs.

IEDC Reports and Studies: The bill requires the IEDC to collaborate with local economic development organizations and submit an annual report to the Interim Study Committee on Economic Development concerning collaborative efforts. The IEDC is also required to conduct a statewide study to determine economic sectors that should be emphasized within geographic regions in Indiana. These provisions may increase expenses for the IEDC, but should be able to be accomplished within the IEDC's existing resources.

Entrepreneurship Education Programs: The bill requires the State Board of Education, the Commission for Higher Education (CHE), and the Department of Workforce Development to develop entrepreneurship education programs for elementary and secondary education, higher education, and individuals in the work force. This provision should be able to be accomplished within the existing resources available to the State Board of Education, the CHE and the DWD.

Technology and Innovation Commercialization Programs: This bill requires higher education institutions to expand technology and innovation commercialization programs. State educational institutions may need to reallocate resources from other programs or areas to meet this requirement.

Capital Access Program: This bill makes numerous changes concerning the Capital Access Program, and they should be able to be accomplished within the IEDC's existing resources.

<u>Background Information</u> - *Capital Access Program*: CAP was created in 1992 under IC 5-28-29 to provide capital to small businesses. The program provides reserve funds to lenders to utilize as additional collateral to secure business loans. The IEDC indicates that the majority of the participating financial institutions are community banks. A participating financial institution must establish a reserve account in which premiums paid by borrowers, lenders, and the state on loans the institution enrolls in CAP are deposited. The money in the reserve account is to be used to back the CAP loans enrolled by the financial institution. If a loan is

uncollectible and charged off by the financial institution, the money in the reserve account is used to pay the uncollectible loan.

Current statute requires that on CAP loans the borrower must pay a premium of 1.5% to 3.5% of the loan value, and this premium must be matched equally by the financial institution. However, current statute also allows for the financial institution's premium to be paid by the borrower. The IEDC indicates that the loan premiums (borrower and lender share) are typically paid by the borrower, so the premium range for the borrower is essentially 3% to 7% of the loan value. Under current statute, the state matches borrower and lender premiums at a rate of 100% to 300%, depending upon enrolled loan values and borrower type. The state matching funds come from the Capital Access Account.

Since the inception of CAP, 3,679 loans have been enrolled totaling about $185.6 M, for an average loan of about $50,000. The premiums paid on these loans have totaled about $7.4 M, with the state match totaling about $8.3 M. A total of 386 loans have been charged off, or about 22 on average per year. The claims against reserve accounts total about $13 M, or about $33,800 per loan. As of October 31, 2010, there are no funds available in the state Capital Access Account.

Explanation of State Revenues: *Summary:* The bill makes the following changes beginning in 2012: (1) reduces the Corporate Adjusted Gross Income (AGI) tax rate from 8.5% to 5%; (2) reduces the Financial Institutions Tax (FIT) rate from 8.5% to 5%; (3) eliminates the exclusion for individual and corporate taxpayers for interest income from state and local bonds; and (4) eliminates certain tax credits. The table below reports the net impact on state revenue from these changes. The offset from elimination of tax credits assumes future credits on contributions, expenditures, or investment made after 2011 would on average be consistent with credits claimed in recent years.

Net Impact (in millions)		
Provision	**FY 2012**	**FY 2013**
Corporate AGI Tax Rate Reduction	(75.8)	(153.3)
FIT Rate Reduction	(13.4)	(26.8)
Elimination of Interest Exclusion	-	59.5
Elimination of Tax Credits	-	7.1
Total	**(89.2)**	**(113.5)**

Corporate and Financial Institutions Tax Reductions: The bill reduces the corporate AGI tax rate and the FIT rate from 8.5% to 5% beginning in tax year 2012. The estimated annual revenue loss from the rate reductions is presented in the table below. The revenue loss is expected to commence in FY 2012 as corporations and financial institutions reduce estimated tax payments. The estimated revenue loss is presented in the table below.

Revenue Loss (in millions)		
Provision	**FY 2012**	**FY 2013**
Corporate AGI Tax Rate Reduction	75.8	153.3
FIT Rate Reduction	13.4	26.8
Total	89.2	180.1

Revenue from the corporate AGI Tax is distributed to the state General Fund. Revenue from the FIT is distributed to local units and to the state General Fund. Local units are annually guaranteed revenue from the FIT. The amount guaranteed to a local unit is equal to the difference between: (1) the amount that was received by the taxing unit in 1989 under financial institutions taxes that were repealed and replaced by the FIT and (2) the amount received in the current year by the taxing unit from property taxes attributable to personal property of banks. FIT distributions to local units occur throughout the fiscal year until the guarantee is met. Any remaining FIT revenue is distributed to the state General Fund. The annual guarantee is roughly $45 M. The Revenue Technical Committee forecast (published December 15, 2010, projects that FIT revenue to the state General Fund will total $20 M in FY 2012 and $20 M in FY 2013. It's estimated that the FIT rate reduction will eliminate all revenue to the state General Fund from this tax in FY 2013. It's also estimated that transfers totaling $6.8 M will have to be made out of the state General Fund to local units in FY 2013 to pay the guaranteed amounts to local units under the FIT.

Exclusion of Interest on State and Local Bonds: The bill eliminates the exclusion of interest income from state and local bonds (except those issued by Indiana or Indiana local governments) from: (1) the individual AGI tax; (2) the corporate AGI tax; (3) and the FIT as it applies to credit unions and investment companies. (Note: Under current statute, financial institutions other than credit unions and investment companies pay tax on interest from state and local bonds, including Indiana state and local bonds.) This change is effective beginning in tax year 2012, so the revenue gain from the change will likely commence in FY 2013. The total revenue gain in FY 2013 is estimated at $59.5 M, with $38.1 M coming from individual taxpayers and $21.4 M coming from corporate taxpayers.

Repatriated Foreign Corporate Dividend Deduction: Under the bill, certain dividends received by a U.S. corporation from a controlled foreign corporation are eligible for up to a 100% dividends-received deduction beginning in tax year 2012. The deduction percentage must be approved by the IEDC. The deducted dividends also must be invested in Indiana under a reinvestment plan approved by both the corporate taxpayer and the IEDC. At the taxpayer's election, the deduction is available for dividends received either: (1) during the taxpayer's taxable year that begins in the year the deduction is approved by the IEDC; or (2) during the taxpayer's taxable year that begins in the year after the year the deduction is approved by the IEDC.

The deduction is also subject to a couple of other limitations. First, the deduction applies only to dividends in excess of the taxpayer's "Olympic" average dividend level over three of the five most recent taxable years. Second, the amount of dividends eligible for the deduction is limited to the <u>greater</u> of: (1) $1M; (2) the amount of earnings shown as permanently reinvested outside the United States on the taxpayer's most recent audited financial statement; or (3) the tax liability shown as attributable to earnings described in (2) divided by 8.5%. If the financial statement fails to show amounts described in (2) and (3), they will be treated as equal to zero and the deduction may equal up to $1 M.

The impact of this provision is unknown. Absent a similar deduction under the Federal Corporate Income Tax (which has an average tax rate of roughly 26% to 27% and a top marginal tax rate of 35%) it would appear that corporations would be unwilling to subject such dividends to the Federal tax in order to receive an 8.5% deduction (or 5% under the tax rate reduction in the bill) on the Indiana corporate tax. In the event that dividends are repatriated under this provision, there would be no negative impact on state revenue since the deductible dividends would have to exceed the normal dividends received by the corporate taxpayer. This also assumes that these "excess" dividends would not otherwise be repatriated and invested in Indiana.

Sunset of Tax Credits: The bill sunsets the income tax credits as described below. The two tables following the explanation of the credit provisions report the number of individual and corporate taxpayers claiming each credit in 2006, 2007, and 2008, and the total credit amount claimed each year. The average annual total credits claimed under these tax credits during the 3-year period was about $7.1 M.

(1) Teacher Summer Employment Compensation Credit: The bill eliminates the tax credit after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer employing a teacher in a qualified position during school summer recess. The credit is equal to the lesser of 50% of the compensation paid to the teacher during the taxable year or $2,500.

(2) Enterprise Zone (EZ) Loan Interest Credit: The bill prohibits the tax credit from being awarded for interest on loans made after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer for interest income earned by the taxpayer from a loan that directly benefits an EZ business, increases EZ property values, or is used to rehabilitate, repair, or improve an EZ residence. The credit is equal to 5% of the loan interest received during the taxable year.

(3) Neighborhood Assistance Credit: The bill eliminates the tax credit after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer contributing to individuals, groups, or neighborhood organizations, or engaging in activities to upgrade economically disadvantaged areas for economically disadvantaged households. The credit is limited to the lesser of 50% of the amount contributed or invested during the taxable year or $25,000. Total credits awarded during any state fiscal year is limited to $2.5 M.

(4) Enterprise Zone Investment Cost Credit: The bill prohibits the tax credit from being awarded for investment made after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer purchasing an ownership interest in an EZ business. The credit varies depending on the type of investment, the type of business, and the number of jobs created. The maximum credit is 30% of the qualified investment.

(5) Maternity Home Tax Credit: The bill prohibits the tax credit from being awarded for providing residence in a maternity home after December 31, 2011. This is a nonrefundable tax credit that may be claimed by a taxpayer owning and operating a registered maternity home that provides a temporary residence for at least 60 days to an unrelated pregnant woman. The maximum credit is $3,000 for a taxable year. Total credits awarded during any state fiscal year is limited to $500,000.

(6) Community Revitalization Enhancement District (CRED) Tax Credit: The bill prohibits the tax credit from being awarded for investment made after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer making qualified investment for the redevelopment or rehabilitation of property located within a CRED. The credit is equal to 25% of the qualified investment during the taxable year.

(7) Credit for Offering Health Benefit Plans: The bill prohibits the tax credit from being awarded for the provision of a health benefit plan after December 31, 2011. This is a nonrefundable tax credit that may be claimed in each of the first two years that an employer makes a health benefit plan available to employees. The credit is equal to $50 per employee enrolled in the employer's health benefit plan, up to a maximum of $2,500 per year in each of the first two years the plan is offered. An employer claiming the credit must offer health insurance for at least 24 consecutive months after the taxable year in which the health benefit plan is initially offered.

(8) Small Employer Qualified Wellness Program Credit: The bill prohibits the tax credit from being awarded for wellness program costs incurred after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an employer providing a qualified employee wellness program certified by the Indiana State Department of Health. The tax credit is equal to 50% of the cost incurred by the taxpayer to provide the wellness program during the taxable year.

Individual Income Taxpayers	**2006**	**2007**	**2008**
Teacher Summer Employment Compensation Credit			
Taxpayers Claiming Credit	22	21	19
Credits Claimed	$11,917	$15,855	$9,199
Enterprise Zone Loan Interest Credit*			
Taxpayers Claiming Credit	22	75	67
Credits Claimed	$13,510	$77,854	$23,260
Neighborhood Assistance Credit			
Taxpayers Claiming Credit	3,208	3,488	3641
Credits Claimed	$1,415,197	$2,232,736	$2,082,432
Enterprise Zone Investment Cost Credit**			
Taxpayers Claiming Credit	7	40	26
Credits Claimed	$22,071	$171,502	$141,739
Maternity Home Tax Credit			
Taxpayers Claiming Credit	15	13	8
Credits Claimed	$6,615	$4,718	$2,056
Community Revitalization Enhancement District Tax Credit			
Taxpayers Claiming Credit	84	55	77
Credits Claimed	$54,228	$416,447	$152,445
Credit for Offering Health Benefit Plans^			
Taxpayers Claiming Credit		214	218
Credits Claimed		$137,189	$155,466
Small Employer Qualified Wellness Program Credit^			
Taxpayers Claiming Credit		83	170
Credits Claimed		$81,631	$180,758
*Includes Airport Development Zone Loan Interest Credit. **Includes Airport Development Zone Investment Cost Credit. ^Effective beginning in tax year 2007.			

Corporate Income Taxpayers	2006	2007	2008
Teacher Summer Employment Compensation Credit			
Taxpayers Claiming Credit	N/R	N/R	N/R
Credits Claimed	$2,500	$2,500	$2,500
Enterprise Zone Loan Interest Credit*			
Taxpayers Claiming Credit	28	20	18
Credits Claimed	$2,441,498	$2,490,933	$967,329
Neighborhood Assistance Credit			
Taxpayers Claiming Credit	18	16	19
Credits Claimed	$26,450	$19,050	$15,337
Enterprise Zone Investment Cost Credit**			
Taxpayers Claiming Credit	0	N/R	0
Credits Claimed	$0	$1,358	$0
Maternity Home Tax Credit			
Taxpayers Claiming Credit	0	0	0
Credits Claimed	$0	$0	$0
Community Revitalization Enhancement District Tax Credit			
Taxpayers Claiming Credit	N/R	N/R	N/R
Credits Claimed	$3,224,231	$2,663,171	$1,697,748
Credit for Offering Health Benefit Plans^			
Taxpayers Claiming Credit		N/R	N/R
Credits Claimed		$2,550	$50
Small Employer Qualified Wellness Program Credit^			
Taxpayers Claiming Credit		9	20
Credits Claimed		$20,681	$50,030
N/R=Five or fewer filers, filer count not reported. *Includes Airport Development Zone Loan Interest Credit. **Includes Airport Development Zone Investment Cost Credit. ^Effective beginning in tax year 2007.			

Explanation of Local Expenditures:

Explanation of Local Revenues: *Exclusion of Interest on State and Local Bonds:* By eliminating the exclusion for interest income from state and local bonds (except those issued by Indiana or Indiana local governments), the would significantly increase taxable income. Consequently, some counties imposing local option income taxes could potentially experience a substantial increase in revenue from these taxes. Based on the current average LOIT rate of about 1.3%, LOIT collections on a statewide basis could potentially increase by about $14.6 M annually. The distribution of this revenue gain across counties is unknown, however.

Redevelopment Financing: Provision (18) would allow local governments to utilize certified shares from CAGIT or distributions from CEDIT for redevelopment financing. Current statute allows distributive shares of the county option income tax (COIT) to be used for this purpose. Any impact would depend upon local action.

State Agencies Affected: DOR; IEDC; State Board of Education; CHE; DWD; State educational institutions.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: OFMA Income Tax databases, 2000-2008. U. S. Census Bureau, *State and Local Government Finances* databases, 1998-2008. U. S. Internal Revenue Service, Statistics of Income Division, *Annual Analysis of Individual Income Tax Returns*, *SOI Bulletins*, Fall 2002-Fall 2010. U. S. Congress, Joint Committee on Taxation, Annual *Estimates of Federal Tax Expenditures* reports, 2008-2010. U. S. Internal Revenue Service, Statistics of Income Division, Annual Corporate and Individual Tax Stats Tables. Matt Tuohy, IEDC, 317-233-9138; Eric Shields, IEDC, 317-234-3997; Auditor's Data.

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